BRIEF AND ARGUMENT FOR PETITIONER.

PROPOSITIONS OF LAW RELIED UPON.

I.

If the "general law", of a particular State is such, that a claim by a trustee in bankruptcy, against a third party for a definite and stated sum of money, alleged to have been voluntarily transferred to such Party, by the Bankrupt more than four months prior to the institution of the Bankruptcy Proceedings, for the purpose of defrauding creditors; is cognizable only in an action at law, in which a trial by a jury is demandable, as of right; The right which such Third Party would have if He were sued in a court of the particular State, by a trustee in bankruptcy, upon such a claim, to demand that the matter be adjudicated in an action at law, is a substantive right; and, one which a Federal Court in which the Bankruptcy Proceeding is pending, is required to accord and grant such Party, if proceedings are instituted by the trustee of the estate in such Federal Court, against such third Party to enforce such a claim.

A.

By virtue of Section 721 of the Revised Statutes (28 U. S. C. A., Tit. 28, Sec. 725), a Federal Court is required to apply the "general law", of the State in a proceeding in equity, the same as in a trial at common law; if the case is not one that arises under the Constitution or the laws of the United States.

Ruhlin v. N. Y. Life Ins. Co., 304 U. S. 202, 82 L. Ed. 1326, 58 S. Ct. 832;

Erie Ry. Co. v. Tompkins, 304 U. S. 64, 58 S. Ct. 817, 82 L. Ed. 1188;

Bruun v. Hanson, 103 Fed. (2nd) 685, 696;

Waybright v. *Columbian Mut. Life Ins. Co.,* 30 Fed. Supp. 885, 888.

B.

The fact that the Party who instituted the proceeding in question, against the Petitioner, was a trustee in bankruptcy, does not render said proceeding, one that arose under the Constitution or the Laws of the United States. In order for a cause to be classed as one that arises under the Constitution or the Laws of the United States, there must be a controversy respecting the validity, construction or effect of a Congressional Enactment; or, a controversy respecting the construction, or effect, of a provision of the Constitution of the United States; upon the determination of which the result depends.

Lovell v. *Newman*, 227 U. S. 412, 421; 57 L. Ed. 577; 33 S. Ct. 375.

C.

A third party against whom a receiver, appointed by a Court of Chancery jurisdiction, or a trustee in bankruptcy; has instituted a proceeding to recover property, which, it is alleged, is part of the *corpus* of the estate in question; is entitled to demand the same substantive rights, including the right to a trial by a jury, that he would be entitled to demand, if a similar claim had been asserted against him by anyone else. The fact that the "main case," is a pending chancery proceeding, or a pending bankruptcy proceeding; does not operate to deprive such party of any substantive rights that he would otherwise have.

Carey v. McMillan, 289 Fed. 380 (8th Circuit);

Britton v. Andrews, 8 Fed. (2d) 950 (8th Circuit);

Hart v. Wiltsee, 19 Fed. (2d) 903, 914 (First Circuit);

Robinson **v.** ***Mutual Reserve Life Ins. Co.,*** 175 Fed. 629;

Whelan **v.** ***Enterprise Transp. Co.,*** 164 Fed. 95.

D.

What *quantum* of evidence is sufficient to create an issue of fact, sufficient to require the submission of a case to the jury, is a question of *substantive* law.

Herron v. Southern Pacific Co., 283 U. S. 591, 593; 51 S. Ct. 383, 75; 75 L. Ed. 857;

New York Life Ins. Co. v. Sparkman, 101 Fed. (2d) 484;

Atchison & I. S. F. Ry. Co. v. Spencer, 20 Fed. (2d) 714, 718.

E.

Prior to the time the Decision in *Erie R. R.* v. *Tompkins,* 304 U. S. 64, 58 S. Ct. 817, 82 L. Ed. 1188, was rendered, this Court and the inferior Federal Courts; uniformly held that the right to have an issue of fact determined by a jury, was a matter of *substantive law;* in reference to which, a Federal Court could exercise its independent judgment, as to what *quantum* of evidence, was requisite to create an issue of fact, that was sufficient to require the submission of a case to a jury.

F.

If, Section 721 of the Revised Statutes (28 U. S. C. A., Tit. 28, Sec. 725), were susceptible of being construed, as authorizing Federal Courts to disregard the "general law", of the State; when determining what *quantum* of evidence was requisite to create an issue of fact sufficient to require the submission of a case to a jury; except in cases arising under the Constitution or the Laws of the United States; said Section must needs be declared unconstitutional. Congress has not been granted the power to prescribe and define substantive rights, in reference

to matters that do not arise under the Constitution or the Laws of the United States.

Erie Ry. Co. v. *Tompkins*, 304 U. S. 64, 78; 58 S. Ct. 817; 82 L. Ed. 1188.

II.

The claim asserted by the Respondent against Petitioner before the Referee in Bankruptcy, was of that nature; that under the "general law", of the State of Illinois; the same could have been enforced only in an action at law, in which the right to a trial by a jury was demandable as of right.

A.

Under the "general law", of the State of Illinois, as evidenced by the Decisions of Its Courts of Review; a claim made by a trustee in bankruptcy against a third party; that a definite and stated sum of money, was voluntarily transferred by the Bankrupt to said Party prior to the adjudication in bankruptcy, and for the purpose of defrauding creditors; is cognizable only in an action at law.

McCormick v. *Page*, 96 Ill. App. 447.

B.

Under the "general law", of the State of Illinois, a court of equity, will not in any case, entertain a cause; unless it is affirmatively and clearly made to appear, from the plaintiff's initial pleading; that no adequate and sufficient remedy exists at law.

Brauer v. Laughlin, 235 Ill. 265, 85 N. E. 283;
County of Cook v. David, 143 Ill. 151, 32 N. E. 176;
Victor Scale Co. v. Shurtleff, 81 Ill. 313.

C.

Under the "general law", of the State of Illinois, a court of equity will not entertain jurisdiction, even where actual fraud is alleged; unless it affirmatively appears from the plaintiff's complaint that adequate relief could not be granted at law.

First National Bank v. Sobosky, 186 Ill. App. 545;
Jack v. Blattner, 148 Ill. App. 451;
Pfau v. Fullenwider, 102 Ill. App. 499;
Schack v. *McKey*, 97 Ill. App. 460.

D.

The claim asserted by the Respondent against Petitioner, was one of that character, which naturally and inherently; was cognizable only in an action at law.

Schoenthal, et al. v. Irving Trust Co., 287 U. S. 92, 53 S. Ct. 50; 77 L. Ed. 185;
Daniel v. Guaranty Trust Co., 285 U. S. 154; 52 S. Ct. 326; 76 L. Ed. 675;
First State Bank of Milliken v. Spencer, 219 Fed. 503;
Mesard v. *Brenner*, 103 Fed. (2d) 332;
Gelinas v. *Buffum*, 52 Fed. (2d) 598.
Lewison v. *Hobart Service Trust Co.*, 49 Fed. (2d) 356.
In Re Cunney, 225 Fed. 426;
In Re Mallow Hotel Corporation, 18 Fed. Supp. 17.

III.

A sufficient quantum of evidence was introduced before the Referee, to create, under the "general law", of the State of Illinois, an issue of fact; sufficient to require the submission of the same to a jury in an action at law.

A.

Five witnesses (Tr. 40-41, 60, 100, 116, 133), testified in substance that Petitioner, prior to the month of May, 1938, had loaned said bankrupts the sum of $3,000.00, and that said sum of $1,500.00 had been paid to Petitioner in the month of May, 1938, in repayment of the balance unpaid on said loan. This evidence, if credited, was sufficient to defeat the claim asserted by the Respondent against petitioner.

B.

Under the "general law", of the State of Illinois, the Court, in an action at law, when passing upon a motion to direct a verdict against the party holding the affirmative of the issue, is without power to direct a verdict; if there is any evidence in the record, which standing alone, tends to prove the material allegations of such party's complaint or answer, as the case may be; even though the probative force of the evidence is such, that if a verdict were rendered, for said Party, the Court would be required to grant such Party's adversary a new trial.

Libby, McNeil & Libby v. *Cook*, 222 Ill. 206; 78 N. E. 599;

White v. *City of Belleville*, 364 Ill. 577; 5 N. E. (2d) 215.

C.

Under the "general law", of the State of Illinois, the Court in an action at law, when passing upon a motion to direct a verdict against the party holding the affirmative of the issue, is without power to direct a verdict; by rejecting competent evidence in favor of the party so holding the affirmative, no matter how improbable the same may be; unless such testimony is contrary to some natural law.

Ziraldo v. Lynch Co., 365 Ill. 197, 200; 6 N. E. (2d) 125;

Trust Co. of Chicago v. Richardson, 290 Ill. App. 464; 8 N. E. (2nd) 530;

Thomason v. Chicago Motor Coach Co., 292 Ill. App. 104; 10 N. E. (2d) 714.

D.

Under the "general law", of the State of Illinois, the fact that the Court, in passing upon a motion to direct a verdict for the plaintiff, is of the opinion that a verdict against the plaintiff must needs be set aside, if returned; does not justify the direction of a verdict for the plaintiff; if there is any evidence tending to support the defendant's contention with reference to the controverted questions of fact.

Bailey 1. Robison, 233 Ill. 614; 84 N. E. 660.

Betchel 1. Marshall, 283 Ill. 486; 119 N. E. 619.

Burger v. St. Louis Bed & Manufacturing Co., 206 Ill. App. 256.

In Re Estate of Morehouse, 249 Ill. App. 432.

E.

Under the "general law", of the State of Illinois, neither the Nisi Prius Courts, nor the Courts of Review have the power, in an action at law, when a trial by a jury has been demanded; to make findings of fact from conflicting evidence; notwithstanding, that the Court may be of the opinion that the weight of the evidence is so unbalanced, that it preponderates overwhelmingly in favor of one party. Where a verdict by a jury, is palpably and manifestly, contrary to the weight of the evidence, the Court may grant the unsuccessful party a new trial; but, the Court is powerless to direct a verdict against a party, even though the overwhelming weight of the evidence is in favor of his adversary.

Mirich 1. Forschner Contracting Co., 312 Ill. 343; 143 N. E. 846;

Shutan v. Bloomenthal, 371 Ill. 244; 20 N. E. (2d) 570;

The Sycamore Preserve Works v. The Chicago & North Western Railway Co., 366 Ill. 111; 7 N. E. (2d) 740.

IV.

Under the "general law" of the State of Illinois, summary jurisdiction may not be exercised, in any case where evidence is introduced, which, if credited, would defeat the claim of the party who is asking for such relief, regardless of how incredible and improbable such evidence may be.

The Diversey Liquidating Corporation v. *Neunkirchen,* 370 Ill. 523, 529; 19 N. E. (2nd) 363, 365-366.

V.

The Petitioner, by challenging the jurisdiction of the Referee, in the answer filed by Petitioner (Tr. 7); and by objecting orally to the proceeding (Tr. 21); took every step that he was required to take, and every step which he could have taken; in order to avail himself of his Constitutional right to a trial by a jury.

Louisville Trust Co. v. Comingor, 184 U. S. 18, 26; 46 L. Ed. 413;

In Re McKinney, 289 Fed. 242.

Ie Re Gottlieb and Co,. 245 Fed. 139;

In Re Hayden, 172 Fed. 623.

ARGUMENT.

May It Please the Court:

It is apparent that the Circuit Court of Appeals did not consider, that Petitioner's substantive rights were governed by the law of the State of Illinois, as evidenced by Its Constitution, Legislative Enactments and the Decisions of Its Courts of Review. Further, it is entirely clear that the Circuit Court of Appeals considered, that this cause was one that was cognizable only in equity; and, hence, that the District Court properly adjudicated the matter, in a proceeding which was of the nature of a complaint in equity; and, therefore, Petitioner had no right to a trial by a jury, by virtue of the Seventh Amendment to the Constitution of the United States.

If the Circuit Court of Appeals, erred in so ruling, it follows that the Petitioner has been denied, not only *substantive, but substantial rights, i. e.,* the right to a trial by a jury as provided by the Seventh Amendment to the Constitution of the United States.

It is now established by this Court that a Federal Court is required to enforce and apply *substantive rights;* in the same manner that a Court of the State in which the Federal Court was located, would be required to enforce and apply such rights, whether the cause was one *at law or in equity;* except in cases that arise under the Constitution or the Laws of the United States (Prop. I, A). Obviously, this Cause was one that did not arise under the

Constitution or the laws of the United States (Prop. I, B). Therefore, if the right to a trial by a jury in an action at law, which the Petitioner might have demanded; if the Respondent had sued the Petitioner in a Court of the State of Illinois, was a *substantive right;* it follows inescapably, that the District Court was required to grant Petitioner a trial by a Jury.

Obviously, the *substantial* right, of one who is sued in equity, and who asserts that the cause is one that is cognizable only in an action at law; is not in the *form* of the proceedings, or the manner, or the style, by which the same are designated; but, the right of a trial by a jury *where such right exists.*

Manifestly, no *substantial* right of the Defendant who was sued in equity, on a claim of such a character, that, under the "general law", of the particular State, the claim was adjudicable only in an action at law, would be violated; unless, the right to a trial by a jury *did not exist* in the particular State; *unless a substantially different* method was provided by the law of the particular State, for conducting proceedings in equity, as distinguished from actions at law.

Hence, it must follow, that if the right of the plaintiff, or the defendant; to an action at law, to have a question of fact submitted to a jury, if there is evidence in the record, sufficient to create an issue of fact, *is substantive;* that the right of one who is sued in equity, to a trial by jury in an action at law, if the cause *is* one, that under the law of the particular State *is* cognizable only in an action at law, *is also a substantive right.*

Prior to the time that the Decision of this Court, reported in *Erie Railway Co.* v. *Tompkins,* 304 U. S. 64; 58 S. Ct. 817, 82 L. Ed. 1188, was rendered; it was held by this Court, and the several Circuit Courts of Appeal, in an almost unbroken line of decisions; that the question, whether or not a certain *quantum* of evidence was sufficient to create an issue of fact which required the submission of a case to a jury; was a question of *substantive* law; and that hence, the Federal Courts could exercise their independent judgments when passing on this question without regard to the "general law", of the particular State; and that therefore the Conformity Act was not applicable to such a situation (Authorities cited, Prop. I. D.).

It is respectfully submitted that no distinction, either legal, or logical, can be formulated, between the nature of the right of a plaintiff in an action at law *to have a jury* determine the amount of damages, if any, that he is entitled to recover; and, the nature of the right of the defendant to a suit in equity, to demand, if the claim asserted *is* one that *is* cognizable in an action at law; that *a jury* determine in an action at law whether or not he is liable to the plaintiff. If the Legislature of a State should enact a statute, which provided that a certain amount of real estate, which was worth a stated sum of money, should be exempt from levy and sale; and that a judgment debtor had the right upon making a demand in the manner provided by law, to have the prescribed amount of real estate set aside as his homestead; and, that in such a case commissioners should be appointed to appraise the land; and, to set aside such an amount, *as they deemed,* was worth the sum specified in the statute; perhaps no one would contend that the right of the debtor

in such a situation, *to obtain the judgment of the commissioners;* was not a substantive right. To assert that the right of the debtor in the situation outlined above, is identical in principle with the right of one who is sued in equity on a claim, that is cognizable only in an action at law; is to state, naught but the obvious.

II.

The only case to be found in the reports of the Courts of Review of this State of Illinois, in which the question, whether or not, a claim made by a trustee in bankruptcy against a third party; for a definite and stated sum of money which is alleged to have been voluntarily transferred by the bankrupt to said party, prior to the adjudication, and for the purpose of defrauding creditors, was cognizable in equity; was expressly decided, is the case of *McCormick* v. *Page,* 96 Ill. App. 44; and, in that case; the Court held: that such a claim was cognizable only in an action at law. However, the principles, declared in many Decisions of the Courts of Review of that State do not leave room for doubt, that such a claim in that State is not cognizable in equity (Authorities cited, Prop. II, B. & C.).

If the nature of the claim asserted by the Respondent against Petitioner were such, that it was manifest in the light of the "general law", on the subject; that a suit at law would be obviously unavailing, then, notwithstanding, what the "general law", of the State of Illinois was on the subject; it might be plausibly contended, that a Federal Court was not required to relegate a trustee in bankruptcy to a remedy, that was futile and inefficacious. This for the reason that a trustee in bankruptcy, the same as the creditors who he represents, has the constitutional right to a remedy that is fairly adapted, to the end sought to be attained.

However, this Court unanimously held in *Schoenthal* v. *Irving Trust Co.*, 287 U. S. 92, 53 S. Ct. 50, 77 L. Ed. 185, that a remedy at law in such a case was complete and adequate; and, that a court of bankruptcy was required in such a situation, to accord to the respondent a trial by a jury, as provided by the Seventh Amendment to the Constitution of the United States. The holding of this Court in the case cited, appears to be in accordance with the clear weight of authority (Prop. II, D.).

If Petitioner's contention, that his right to a jury trial under the Constitution and the "general law", of the State of Illinois, was *a substantive right*, it follows; that he has been denied the right to a trial by a jury as provided by the Seventh Amendment to the Constitution of the United States; *i. e.*, a jury trial in a situation, where under the "general law," that was applicable, and controlling in a Federal Court; the right to a jury trial existed. If Petitioner's assertion, that such a right was a substantive right be deemed untenable, then it follows that the decision of the Circuit Court of Appeals in the instant case, was in conflict with the rule declared by this Court, in *Schoenthal* v. *Irving Trust Co.*, 287 U. S. 92, 53 S. Ct. 50, 77 L. Ed. 185.

III.

It is considered, that it is perhaps, unnecessary to state, that the testimony of five witnesses (Tr. 40-41, 60, 100, 116, 133), to the effect, that Petitioner received the money in question in payment of a debt, more than four months prior to the institution of the Bankruptcy Proceeding; was, regardless of the character of the conflicting evidence, if any; sufficient, if credited, to defeat the claim which the Respondent asserted against Petitioner.

Under the "general law", of the State of Illinois, as evidenced by the repeated Decisions of the Supreme Court of that State; and, by the Intermediate Courts of Review; a sufficient *quantum* of evidence exists to create an issue of fact, which must be submitted for determination by a jury, "Whenever there is evidence, which if credited, would be sufficient to warrant a verdict and judgment in favor of the party holding the affirmative of the issue"; and, that the Court may not direct a verdict; notwithstanding that there is conflicting evidence of an overwhelming character. Moreover, it is settled beyond controversy that neither the Nisi Prius Court, nor the Intermediate Courts of Review, nor the Supreme Court of the State; have the power to terminate an action at law, by making a finding of facts, when a trial by a jury has been demanded; regardless of the fact that the evidence may preponderate overwhelmingly, in favor of one party (Prop. III, B. C. D. E.).

IV.

It is too clear for argument, that a referee in bankruptcy may not, over the objection of the respondent, exercise summary jurisdiction, in any case, where evidence is introduced of such weight; that if a plenary suit had been instituted against the respondent, the Court would not have had, the power to strike the defendant's plea or answer, as a sham pleading. Indeed, it is manifest, that Congress does not possess the constitutional power to confer upon referees in bankruptcy, jurisdiction to adjudicate claims summarily, in any situation, other than that above described. The power of a court to strike a plea or answer from the files as a sham pleading; and to enter judgment for the plaintiff summarily; is a power that has been recognized and exercised for centuries.

Likewise: the power conferred by statutes, in many States, to enter a judgment summarily, when it is affirmatively made to appear, that no substantial defense exists; is, but a recognition and an application; of this inherent power of a court, to enter a judgment when no substantial defense exists.

That summary jurisdiction may never be exercised under the "general law" of the State of Illinois, whenever there is evidence, which if credited and believed, would be sufficient to defeat the claim asserted, was stated by the Supreme Court of Illinois in the case of *Diversey Liquidating Corporation* v. *Neunkirchen*, 370 Ill. 523, 529; 19 N. E. (2nd) 363, 365-366.

V.

It is perhaps unnecessary to state, that the Petitioner by challenging the jurisdiction of the Referee, in the answer filed by Petitioner (Tr. 7); and by objecting orally to the proceedings (Tr. 21); took every step that he was required to take, and every step which he could have taken, in order to avail himself of his constitutional right to a trial by jury (Authorities cited, Prop. V.).

The Petitioner does not here contend, that he has established the right, to have this Court exercise its discretionary power to issue a writ of certiorari; merely because a *prima facie* showing has been made, that the judgment of the Circuit Court of Appeals in the instant case was contrary to the applicable decisions of this Court. The Petitioner does contend, however, that the questions presented, do involve questions of such importance, that the same should be definitely settled by this Court. The rule which the Petitioner contends should be declared and stated by this Court is: By virtue of the Seventh Amend-

ment to the Constitution of the United States, a Federal Court, in any case, other than one which arises under the Constitution or the Laws of the United States, must accord to the parties a jury trial, whenever the nature of the claim asserted, is such; that, under the "general law", of the particular State, the right to a jury trial exists.

It is impossible to reconcile the Holding of the Circuit Court of Appeals for the Seventh Circuit, in this case, that "The case is one that turns on credibility"; with the rule declared by the Circuit Court of Appeals for the Second Circuit, in the case of *B. & O. Highway Transp. Corp.* v. *Irving Trust Co.*, 62 Fed. (2d) 763 (764), as follows:

> "The rule has long been settled that a trustee, to succeed in capturing summarily property held by a third party, must be able to show from facts which no fair mind can dispute that the claim to the property so held is so unsubstantial and obviously insufficient, either in fact or in law, as to be plainly without color of merit or a mere pretense."

Nor, is it possible, to reconcile the Decision of the Circuit Court of Appeals for the Seventh Circuit, in this case, with the Decision rendered by the Circuit Court of Appeals for the Second Circuit in the matter entitled, "*In re Yorkville Coal Co.*" (211 Fed. 619, 620), where the Court declared as follows:

> "The purpose of the preliminary investigation is to find out whether there are any facts which might form a basis of an adverse claim so as to send it to trial in a plenary suit. When the inquiry discloses such facts the purpose of the preliminary investigation is accomplished, and the inquiry should then have been brought to a close. In this preliminary investigation in the bankruptcy court there is no right to try the claim upon the merits, to weigh testimony against testimony, and to find certain testimony

to be true and certain testimony not to be true. That would be to deny the parties the right to a trial before a jury."

It is therefore respectfully submitted that the Writ of Certiorari should issue; that the judgment of the Circuit Court of Appeals for the Seventh Circuit, and the order of the District Court from which the appeal was taken, should each be reversed; and that this Cause be remanded to the District Court of the United States, Northern District of Illinois, with instructions to dismiss the proceedings instituted by the Respondent, without prejudice to his right to institute an action at law.

Respectfully submitted,

HAROLD O. MULKS,
Attorney for Petitioner.

Office - Supreme Court, U. S.
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CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1940.

NO. 765

In the Matter of JOHN GALLIS, Bankrupt, and JAMES L. GALLIS, Bankrupt.

JOHN COTSIRILOS,

Petitioner,

v.

MAURICE KLEIN, Trustee,

Respondent.

AN ADDITIONAL AUTHORITY CITED IN SUPPORT OF THE PROPOSITIONS PRESENTED IN THE PETITION FOR A WRIT OF CERTIORARI.

HAROLD O. MULKS,
Attorney for Petitioner.
155 N. Clark Street,
Chicago, Illinois.

U. S. Law Printing Company, 2817 N. Halsted St., Chicago, Ill.

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STATEMENT.

May it Please the Court:

Counsel for the Petitioner, did not at any time, prior to the completion and filing of the Petition for a Writ of Certiorari; know of the decision that was rendered by the Circuit Court of Appeals for the Fourth Circuit, in the cause entitled, "*Warner* v. *Brady*"; and reported in 115

Fed. 2nd 89. Counsel for the Petitioner, considers, that the opinion of the Court, that was delivered in said cause; and which is set forth in full hereinafter; will be of material assistance to this Court, in passing upon the questions presented by the Petitioner, in his application for the writ.

The sixth and the twelfth paragraphs of the Court's opinion (115 Fed. 2nd 92, pp. 5-7, 11 of this document), is regarded by counsel, as being especially pertinent to the inquiry. In said paragraphs the Circuit Court for the Fourth Circuit, placed the same construction upon, *May* v. *Henderson*, 268 U. S. 111, and *Harrison* v. *Chamberlain*, 271 U. S. 191, that the Petitioner has placed upon the same, at all times; and one that was antipodal, to the construction placed upon said two decisions of this Court, by the Circuit Court of Appeals for the Seventh Circuit, in the instant case (Tr. 170, 115 Fed. 2nd 662).

It is considered that the opinion of the Court in, "*Warner* v. *Brady*," illustrates strikingly, the irreconcilable conflict, that still persists between the several Circuit Courts of Appeal, on this question; and also the imperative necessity of having the question definitely settled by this Court. It is considered by counsel that the submission of this opinion to this Court, which regrettably, will to some extent, augment its work; is excusable at least, even if not strictly proper, under the circumstances.

SOPER, Circuit Judge.

(1) "Francis L. Warder a special receiver appointed by the Circuit Court of Taylor County, West Virginia, for the benefit of the bondholders of the Maryland Coal Company of West Virginia, appeals from a turnover order of the District Court whereby he was sum-

marily directed to pay the sum of $2,475.52 held by him for the bondholders, to A. Spates Brady, a trustee for the Coal Company appointed by the District Court in a reorganization proceeding under Ch. X of the Bankruptcy Act of June 22, 1938, 52 Stat. 883 *et seq.*, 11 U.S.C.A. Sec. 501 *et seq.* The grounds of the appeal are that the District Court was without jurisdiction to decide the controversy and pass the order in a summary proceeding, and that in any event, the order was not justified on its merits by the circumstances of the case."

(2) "The fund came into existence during the course of a receivership proceeding in the State court, which was instituted by the creditors of the corporation on November 12, 1932. The receiver therein operated the mines of the corporation under the authority of the court. On January 27, 1936 an intervening petition was filed on behalf of the holders of certain income bonds dated July 6, 1911 and due February 1, 1941, which had been issued by the company in the aggregate sum of $257,500 and contained the following provision: "The Directors shall set aside from the proceeds of the sales of coal mined from the property of the company, a fund equal to five cents per gross ton on all coal mined, and such further sum as may fairly represent the depreciation of the mining plant connected therewith. With this fund, and such other funds as the Directors may appropriate the Directors may from time to time, purchase, or redeem at par, this Bond or any or all of the Bonds issued hereunder." The petitioners alleged that for a great many years prior to the receivership the company had failed and neglected to comply with the quoted provision, and no such fund had been established or maintained, and that the operating receiver had likewise failed in this respect; that with the exception of the bonded indebtedness, all other debts of the company and all costs of the proceeding

had been paid, or would be paid in the year 1936, and that the property in the hands of the receiver would be turned back to the company, and that it was reasonable to believe from the past conduct of those in control of the company that the property would be wasted, dissipated and mismanaged, so that there would be no funds for the payment of the bonds when they fell due; and that there were not sufficient properties belonging to the company to pay the bonds in full. It was further alleged that the receiver had operated the mines at a profit, and it was prayed that the court direct the receiver to retain possession of the property and to continue the operation of the mines for the benefit of the bondholders. The questions raised by the intervening petition were considered by the state court, and further proceedings were had which resulted in a decree of December 31, 1937, wherein a description of the property found by the court to be owned by the company was set out, the amount of the outstanding bonds was found to be $257,500, and the owners thereof were ascertained; and it was decreed that the property of the company should be charged in equity with a lien in favor of the bondholders. The receiver was ordered to turn over the property to the company, which was directed to set aside a fund as provided in the quoted provision of the bonds until the further order of the court "unless such bonds are sooner redeemed and until such bonds so set aside shall equal the sum of $257,500". The company was also directed to pay interest on the bonds to the bondholders, and to pay all sums set aside for the benefit of the bondholders in accordance with the provisions of the bonds, to Francis L. Warder, who was appointed a special receiver to receive the moneys which were "to be held by him for the benefit of the bondholders until the further order of this court". The operating receiver was also directed to pay any surplus remaining in his hands after the settlement of his accounts to Warder, to be held by him for the same purpose. It was further

directed that Warder might from time to time under the order of the court purchase the bonds or any of them by calling for bids on a discount basis or redeem at par any or all of said bonds."

(3) "Under this decree, the special receiver received certain sums of money from the company and also a larger sum from the operating receiver, after the latter had stated his accounts and had been directed by a subsequent order of July 1, 1938, to pay to Warder the surplus in his hands. The special receiver, acting under the orders of the state court, thereafter made certain payments from the fund in the redemption or purchase of some of the bonds at a discount, after the bondholders, upon notice, had submitted bids therefor; and there remained in his hands when the present controversy arose the sum of $2,511.18."

(4) "This controversy began on September 20, 1939, when the trustee in the reorganization proceeding prayed the District Court to stay further proceedings in the state court and to order the special receiver therein to turn over the funds in his hands. It was alleged in the trustee's petition that the fund in the hands of the special receiver belonged to the debtor and that it could be advantageously used by the trustee as working capital in operating the business of the debtor. In answer to the petition the special receiver appeared specially and filed an answer in which the aforegoing facts were set out and it was alleged that the legal title to the fund was vested in him for the use and benefit of the bondholders who held the equitable title thereto, and that the fund was not and never had been the property of the debtor. The matter was heard summarily upon the petition and answer. The court ordered that the fund should be transferred to the trustee and that all further proceedings in the state court should be stayed, and referred the matter to a referee to ascertain the amount of the fund. An accounting was accordingly had, and thereupon, on February 10, 1940, the court passed the turn over

order appealed from, directing the special receiver to pay to the trustee the sum of $2,475.52, being the amount of the fund in his hands less certain allowances. From this order the pending appeal was taken."

(5) "The special receiver seems to contend that the District Court was without power to pass this order in a summary proceeding because of the provisions of Sec. 23 of the Bankruptcy Act, 11 U.S.C.A. Sec. 46, as interpreted by the decisions of the courts. This section was reenacted with minor changes as part of the Chandler Act of June 22, 1938. It provides in substance that the United States District Courts shall have jurisdiction of all controversies at law and in equity, as distinguished from proceedings under the act, between receivers and trustees as such and divers claimants, concerning the property acquired or claimed by the receivers or trustees, in the same manner and to the same extent as though such controversies had been between the bankrupt and the adverse claimants; and suits by the receiver and the trustee, with certain exceptions, shall be brought or prosecuted only in the courts where the bankrupt may have brought or prosecuted them if bankruptcy proceedings had not been instituted, unless by the consent of the defendant."

(6) "It is well settled by decisions interpreting this section that property or money held adversely to the bankrupt can only be recovered in a plenary suit and not by a summary proceeding in a bankruptcy court. The mere assertion of an adverse claim is not sufficient to oust the jurisdiction of the courts of bankruptcy, for they have power to inquire preliminarily whether the claim is so unsubstantial and obviously insufficient, either in fact or in law, as to be plainly without merit; and if so, to dispose of it summarily. On the other hand, if the claim be found to be substantial and the property is in the possession of the claimant, the court is without jurisdiction to proceed at all even in a plenary proceeding without the consent of the defend-

ant, unless the other conditions prescribed by the statute are met. *May* v. *Henderson*, 268 U. S. 111, 115, 116, 45 S. Ct. 456, 69 L. Ed. 870; *Taubel, etc., Co.* v. *Fox*, 264 U. S. 426, 432, 433, 44 S. Ct. 396, 68 L. Ed. 770; *Harrison* v. *Chamberlin*, 271, U. S. 191, 46 S. Ct. 467, 70 L. Ed. 897; *MacDonald* v. *Plymouth Trust Co.*, 286 U. S. 263, 52 S. Ct. 505, 76 L. Ed. 1093; *In re Rathman*, 8 Cir., 183 F. 913; *Central Republic Bank & Trust Co.* v. *Caldwell*, 8 Cir., 58 F. 2d 721, 730; *Marcell* v. *Engebretson*, 8 Cir., 74 F. 2d 93, *certiorari* denied 296 U. S. 579, 56 S. Ct. 89, 80 L. Ed. 409; *In re Indiana Flooring Co.*, 2 Cir., 62 F. 2d. 763, 764. There can be no doubt that under these authorities the claim of the special receiver in the pending case would be considered substantial and adverse within the meaning of Sec. 23. At the time of the institution of the reorganization proceeding, the fund was not actually or constructively in the possession of the trustee, but in the possession of the special state court receiver who set up the substantial and bona-fide contention that the title to the fund resided in him under the decree of the state court and not in the bankrupt."

(7) "Another restriction upon jurisdiction that has been recognized by the courts of bankruptcy (as well as courts of equity) is the rule of comity which forbids one court from exercising control over the property of the debtor which is already the subject of proceedings in another court, and permits the court first acquiring possession of the property to continue its administration without interruption until it is complete. This principle has had complete recognition in this and other federal courts. *Griffin* v. *Lenhart*, 4 Cir., 266 F. 671; *Straton* v. *New*, 283 U. S. 318, 51 S. Ct. 465, 75 L. Ed. 1060; Finletter, *The Law of Bankruptcy Reorganization*, 1939 Ed. pp. 115 to 121. If applied to the pending case, it would oust the jurisdiction of the bankruptcy court for the evidence shows clearly that the fund in litigation had been created in accordance with the decree of the state court, and had

been placed in the custody of its special receiver long before the institution of the reorganization proceedings in bankruptcy. Furthermore, the fund was created at the conclusion of an equity receivership instituted for the benefit of creditors generally, when all the creditors, except the bondholders, had been paid and the property in the hands of the operating receiver had been turned back to the corporation. The receivership therefore was no longer an insolvent proceeding, which, notwithstanding the rule of comity, was subject to supersession by the bankrupt court under the paramount bankruptcy power, *Gross* v. *Irving Trust Co.*, 289 U. S. 342, 53 S. Ct. 605, 77 L. Ed. 1243, 90 A. L. R. 1215; *Taylor* v. *Sternberg*, 293 U. S. 470, 55 S. Ct. 260, 79 L. Ed. 599."

(8) "We are concerned in the pending case, however, with the Act of 1938 which was passed for the very purpose of modifying these restrictions upon the jurisdiction of the bankruptcy court when engaged in a reorganization proceeding under Ch. X of the statute. First, it is important to note that Sec. 23 of the Act of 1938 does not affect the present controversy; for while it is provided by Sec. 102, 11 U. S. C. A. Sec. 502, that Chs. I to VII of the act (including therein Sec. 23), to the extent that they are not inconsistent with Ch. X, shall apply to proceedings under that title. It is also provided that Sec. 23 (and other sections) shall not apply in such a proceeding unless an order shall be entered by the court directing that bankruptcy be proceeded with pursuant to Chs. I to VII. Accordingly, the restrictions contained in Sec. 23 do not limit the jurisdiction of the court in the pending reorganization proceeding."

(9) "Moreover, the rule of comity is relaxed with respect to proceedings under Ch. X. The special exceptions to the rule contained in Secs. 60, 67 and 70 of Ch. VII of the Act, 11 U. S. C. A. Secs. 96, 107, 110 are made applicable to proceedings under Ch.

X by Sec. 102; and more important for our purposes, Secs. 256 and 257, 11 U. S. C. A. Secs. 656 and 657, provide that a reorganization petition may be filed under Ch. X notwithstanding the pendency of a prior mortgage foreclosure, equity or other proceeding in a federal or state court in which a trustee or receiver of all or any part of the property of the debtor has been appointed, and that a trustee appointed under Ch. X, or the debtor, if continued in possession of the property, shall become vested with the rights, if any, of such prior receiver or trustee in such property with the right to immediate possession thereof. Secs. 113, U. S. C. A. Sec. 513 empowers the judge, prior to the approval of a petition in reorganization, upon cause shown, to grant a temporary stay, until the petition is acted upon, of a prior pending bankruptcy, mortgage, foreclosure or equity receivership proceeding, and of any act or other proceeding to enforce a lien against a debtor's property; Sec. 116 (4), 11 U. S. C. A. Sec. 516 (4), empowers the judge, upon the approval of a petition to enjoin or stay until final decree the commencement or continuation of a suit against the debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor; and Sec. 2 sub. a (21) 11 U. S. C. A. Sec. 11, sub. a (21) invests the courts of bankruptcy with such jurisdiction at law and equity as will enable them to exercise original jurisdiction in proceedings under Ch. X, amongst other things, to require receivers or trustees appointed in proceedings not under the act, assignees for the benefit of creditors and agents authorized to take possession of or to liquidate a person's property, although appointed more than four months prior to bankruptcy, to deliver the property in their possession or under their control to the receiver or trustee appointed under the act, and in all such cases, to account to the court for the disposition by them of the property of the bankrupt or debtor. Obviously these provisions go far to restrict the application of the rule of comity in the particular cases

described in the quoted sections, and thus to enlarge the jurisdiction of federal courts over adverse claims."

(10) "Moreover, there are provisions of even greater scope affecting the jurisdiction of the bankruptcy court that refer to the dependent jurisdiction which is conferred upon a federal court upon the appointment of a receiver of the debtor's property. This kind of jurisdiction is described in *Riehle* v. *Margolies*, 279 U. S. 218, 223, 49 S. Ct. 310, 312, 73 L. Ed. 669, as follows: 'The appointment of a receiver of a debtor's property by a federal court confers upon it, regardless of citizenship and of the amount in controversy, federal jurisdiction to decide all questions incident to the preservation, collection, and distribution of the assets. It may do this either in the original suit, *Rouse* v. *Letcher*, 156 U. S. 47, 49, 50, 15 S. Ct. 266, 39 L. Ed. 341; or by ancillary proceedings, *White* v. *Ewing*, 159 U. S. 36, 15 S. Ct. 1018, 40 L. Ed. 67. Compare *Kelley* v. *Gill*, 245 U. S. 116, 119, 38 S. Ct. 38, 62 L. Ed. 185. And it may, despite section 265 of the Judicial Code (28 U. S. C. A. Sec. 379), issue under section 262 (28 U. S. C. A. Sec. 377), or otherwise, all writs necessary to protect from interference all property in its possession. *Julian* v. *Central Trust Co.*, 193 U. S. 93, 112, 24 S. Ct. 399, 48 L. Ed. 629.' "

(11) "The possession of this jurisdiction by the bankruptcy court in a reorganization proceeding is confirmed by the provisions of Ch. X Sec. 115, 11 U. S. C. A. Sec. 515, provides that upon the approval of the petition in reorganization proceedings, the court shall have in addition to the jurisdiction, powers and duties of a bankrupt court, all the powers which a court of the United States would have if it had appointed a receiver in equity of the property of the debtor on the ground of insolvency or inability to meet its debts as they mature; and Secs. 187 and 188 11 U. S. C. A. Secs. 587 and 588, permit a trustee or debtor in possession, if authorized by the judge, to

exercise such rights and powers as a receiver in equity would have if appointed by a federal court. Heretofore, the dependent jurisdiction of the courts of bankruptcy was restricted by Sec. 23 and by the rule of comity, but now that Sec. 23 is no longer applicable to reorganization proceedings under Ch. X, and the power to interfere in a prior court proceeding has been conferred upon the bankruptcy court by Congress in the exercise of the bankruptcy power, it seems clear that the bankruptcy court under Ch. X has jurisdiction to entertain all suits to which its trustee or the debtor in possession is a party, even though they be instituted against adverse claimants. See Finletter, *The Law of Bankruptcy Reorganization*, 1939 Ed. p. 181. It is significant that in *Kelley* v. *Gill*, 245 U. S. 116, 38 S. Ct. 38, 62 L. Ed. 185, the jurisdiction of the bankruptcy court to entertain a dependent suit in equity to enforce the collection of unpaid stock subscriptions due a bankrupt corporation was denied because of the applicable provisions of Sec. 23."

(12) "It does not follow, however, that the jurisdiction of the bankruptcy court over suits against an adverse claimant may be summarily exercised. The statute does not so provide; and under the well established procedural rule of the ordinary bankruptcy courts, as we have seen, suits by a trustee to recover property from an adverse claimant in possession must take the form of a plenary action. This is especially true when the title to property is in dispute. The rule was applied in *Taubel, etc., Co.* v. *Fox*, 264 U. S. 426, 44 S. Ct. 396, 68 L. Ed. 770, where the court discussed the bearing of Secs. 67, sub. e, 60, sub. b, and 70, sub e of the Bankruptcy Act, which confer jurisdiction upon the bankruptcy court under certain circumstances over suits by trustees for the recovery of property in the possession of adverse claimants under conveyances from the bankrupt. Although the jurisdiction of the court was beyond dis-

pute, the necessity for plenary suit was emphasized (264 U. S. page 434, 44 S. Ct. 396, 68 L. Ed. 770). As to the power of Congress in the premises, the court said (page 430 of 264 U. S., page 398 of 44 S. Ct., 68 L. Ed. 770): " 'Congress has, of course, power to confer upon the bankruptcy court jurisdiction to adjudicate the rights of trustees to property adversely claimed. In matters relating to bankruptcy its power is paramount. Hence, even if the property is not within the possession of the bankruptcy court, Congress can confer upon it, as upon any other lower federal court, jurisdiction of the controversy, by conferring jurisdiction over the person in whose possession the property is. Congress has, also (subject to the constitutional guaranties), power to determine to what extent jurisdiction conferred, whether through possession of the *res* or otherwise, shall be exercised by summary proceedings and to what extent by plenary suit. But Congress did not, either by section 2, section 23 of the Bankruptcy Act of 1898 or any other provision of the act, confer generally such broad jurisdiction over claims by a trustee against third persons. Nor has it provided in terms, that a substantial adverse claim to property which is not in the possession of the bankruptcy court, and which is demanded by the trustee under subdivision 'f' of section 67, may be litigated, without consent, by a summary proceeding. To sustain the judgment under review, a specific grant of power to so deal with such a controversy must be shown.' "

(13) "These cases related to ordinary bankruptcy procedure, and are not conclusive here. The bankruptcy court in reorganization proceedings under Sec. 77B, 11 U. S. C. A. Sec. 207, had, and under Ch. X of the 1938 Act now has a wider control, that comprehends not only property of the debtor in his actual or constructive possession, but also property of the debtor in hands of lien holders. The formulation of a plan of reorganization contemplates a readjustment of secured as well as unsecured debts, and so the summary

power of the court extends to all of the debtor's property that can be affected by a plan, whether or not the property is in his possession. Thus in *Continental, etc., Bank & Trust Co.* v. *Rock Island Ry.*, 294 U. S. 648, 55 S. Ct. 595, 79 L. Ed. 1110, in a proceeding for the reorganization of a railroad under Sec. 77, 11 U. S. C. A. Sec. 205, the court granted an injunction in a summary proceeding against certain banks which held the bonds of the railroad as collateral and enjoined a sale of the collateral during the pendency of the procedure. The propriety of a summary rather than a plenary proceeding was sustained because an adverse claim to the property was not involved. The court said (page 681 of 294 U. S., page 608 of 55 S. Ct., 79 L. Ed. 1110): "It is next contended that the court was without power to issue the injunction in a summary proceeding. Obviously, an Application for an injunction against the immediate enforcement of a remedy is not the assertion of an adverse claim. The bonds deposited as collateral were not in the hands of purchasers, but in the hands of creditors as security. That the equity which the debtor retained was a property interest was not and could not be disputed by the creditors; nor was the claim of the creditors in respect to their rights in the collateral security or the rank of their liens questioned by the debtor. In short, no adverse claim was brought forward by either of the parties to the controversy. The only question was in respect of the creditors' remedy; and the sole point is as to the authority of the bankruptcy court to delay for a reasonable time an interference with the reorganization proceeding which would result from an immediate sale of the collateral. The court below dealt adequately with the situation and its conclusions find ample support in the decisions. See, for example, *In re Purkett, Douglas & Co.*, (D. C.) 50 F. 2d 435, 438; *John Matthews, Inc.* v. *Knickerbocker Trust Co.*, (2 Cir.) 192 F. 557; *Allebach* v. *Thomas* (4 Cir.) 16 F. (2d) 853.'

See also, *In re Prudence Bonds Corp.*, 2 Cir., 77 F. 2d. 328; *Grand Boulevard Inv. Co.* v. *Strauss*, 8 Cir. 78 F. 2d. 180; *In re Argyle-Lake Shore Bldg. Corp.*, 7 Cir. 78 F. 2d. 491; *In re Frances E. Willard Natl. Temperance Hospital*, 7 Cir. 82 F. 2d. 804; *In re Prima Co.*, 7 Cir., 98 F. 2d. 952; and see Finletter, *The Law of Bankruptcy Reorganization*, 1939 Ed. pp. 156-166."

(14) "The pending case grows out of a reorganization proceeding under Ch. X and must be decided accordingly. The procedure is determined by the admitted facts that the fund is in the possession of an adverse holder, and the title of the fund is in dispute. If the contention of the special receiver is sustained, the reorganization court will have no interest in the fund, since in such event it will constitute no part of the debtor's estate. It follows that recovery of the fund may be sought only in a plenary suit."

(15) "The order of the District Court might be reversed simply on the ground that it was based upon inadequate procedure; but it is desirable to add, in order to speed the settlement of the bankrupt estate, that under the undisputed facts the trustee in bankruptcy has no interest in the fund that would justify a turnover order in any form of action. Indeed it is difficult to decide one question without deciding th other. The record shows that the sinking fund for the benefit of the bondholders was established when the receivership for the benefit of creditors generally came to an end. Under the decree of the state court this fund that the debtor was obligated to accumulate for the retirement of the bonds was taken from its control and entrusted to the special receiver. This action amounted to an appropriation of the fund to the purpose specified, so that the corporation parted with all title thereto. Indeed the fund was established by the decree of the court which directed the payment of the surplus in the hands of the operating receiver to the special receiver, and this step was

taken to compensate in part for the debtor's prior failure to observe the covenant in the bond. The subsequent payments by the corporation to the receiver of small amounts to be added to the funds were in the same category; and it was the clear intent of the decree to vest the full ownership of the whole fund in the bondholders. The subsequent use of the fund in the purchase of bonds at varying discounts under the order of the court was of benefit to the debtor and did not provoke any opposition on its part or on the part of the bondholders. It was in any event a matter of which the state court had sole control in the execution of its decree."

(16) "A sinking fund under a bond mortgage is a trust fund, the title to which passes from the debtor to the trustee who holds it for the benefit of the bondholders. *Equitable Trust Co.* v. *Green Star S. S. Corp D. C.*, 291 F. 650, affirmed 2 Cir. 297 F. 1008; *Rogers Locomotive, etc., Works* v. *Kelley*, 88 N. Y. 234; *Holland Trust Co.* v. *Sutherland*, 177 N. Y. 327, 69 N. E. 647. So it has been held that the debtor retains no interest in the fund that is subject to the attack of other creditors, and that a receiver appointed under a creditors' bill cannot gain possession of the fund and use it for the benefit of the creditors as a whole. *Truby* v. *M. & T. Trust Co.*, 141 Misc. 507, 510, 253 N. Y. S. 108; *Tennessee Bond Cases*, 114 U. S. 663, 698, 5 S. Ct. 974, 1098, 29 L. Ed. 281; *Babcock P. P. Mfg. Co.* v. *Ranous* 164 N. Y. 440, 58 N. E. 529; *First Union Trust & Savings Bank* v. *Bernardin*, 8 Cir., 60 F. 2d. 419. Applying the principle of these decisions, we conclude that the ownership of the fund was finally adjudicated by a court of competent jurisdiction and the title passed from the debtor before the institution of the bankruptcy proceeding; and, therefore, the fund is not property of a debtor in the possession or control of a receiver appointed in proceedings not under the Bankruptcy Act, which under the terms of the act should be de-

livered to the trustee in bankruptcy. The retention of possession of the fund by the special receiver need not interfere with the execution of any plan of reorganization that may be formulated in accordance with the terms of the act."

"The order of the District Court will be reversed and the case will be remanded with direction to dismiss the petition of the trustee upon which the turnover order was based."

"Reversed and remanded."

The opinion of the Circuit Court of Appeals for the Fourth Circuit, is respectfully submitted to this Court for its consideration, with an apology, for the failure of counsel to become apprised of the same; before the completion and filing of the Petition for a Writ of Certiorari in this matter.

Respectfully submitted,

HAROLD O. MULKS,
Attorney for Petitioner.